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July 2, 2007

Mr. Howard G. Borgstrom
Director
Business Operations Center
Office of the Chief Financial Officer
U.S. Department of Energy
Mailspot CF-60
Room 4A-21
1000 Independence Ave, SW
Washington, DC 20585

RE: CURC Comments on DOE's Notice of Proposed Rulemaking and Opportunity to Comment: Loan Guarantees For Projects That Employ Innovative Technologies; RIN 1901-AB21

Dear Mr. Borgstrom:

Attached please find the comments of the Coal Utilization Research Council in response to the Department of Energy's Notice of Proposed Rulemaking and Opportunity to Comment with respect to the Energy Policy Act 2005's Title XVII loan guarantee program.

If you have any questions, please do not hesitate to contact me at the number provided above. Thank you for your time and attention to this matter.

Sincerely,

Mona Tandon
Attorney for the Coal Utilization Research Council.

Attachment.

Comments Of The Coal Utilization Research Council
On The Department Of Energy's Notice Of Proposed Rulemaking
"Loan Guarantees For Projects That Employ Innovative Technologies"
RIN 1901-AB21
July 2, 2007

On May 16, 2007, the Department of Energy ("DOE" or "Department") published a Notice of Proposed Rulemaking ("NOPR") proposing policies and procedures applicable to DOE's loan guarantee program authorized by Title XVII of the Energy Policy Act of 2005 ("EPAct 2005").[1] The Coal Utilization Research Council ("CURC" or "Council") hereby respectfully submits the following comments regarding DOE's NOPR.

1. BACKGROUND

A. Coal Use in the United States

U.S. economic growth and worldwide sustainable development depends upon plentiful and relatively low cost supplies of energy and industrial feedstock made readily available to consumers. One of the critical components of the domestic and international energy portfolio is coal, which can be a cost-competitive and efficient resource for the transportation and chemical feedstock sectors. Coal, which comprises 90% of combined U.S. energy reserves, currently fuels 50% of the electricity generated in the United States. There is no doubt that coal will remain an indispensable fuel in the U.S. well into the next century, even with a three-fold increase in the consumption of natural gas as well as an increased use of renewable sources of energy and decreased use of petroleum products for power generation. By the year 2015, coal use is expected to double, from the current 25% to 50% of worldwide energy consumption, as developing countries seek an increasing supply of readily available, least-cost energy. Further, in light of the enormous use of petroleum products in the transportation and industrial sectors, and the attendant impacts of changes in oil prices on the global economy, it is probable that coal will play an increasingly important role in the transportation and industrial sectors as petroleum stocks diminish and prices rise.

Given these factors, coal is projected to remain a vitally important feedstock to the global economy. Coal use will be maintained and enhanced as a result of continued development and widespread use of technologies that improve the cost competitiveness of coal; enhance the efficiency by which coal is converted to useful energy; and ensure the environmental impacts of coal use are minimized. Government and industry must work together to support an appropriate balance of short-term and long-term activities required to develop and commercialize technology which will permit the economic, efficient and environmentally compatible use of coal.

B. The Coal Utilization Research Council

The Coal Utilization Research Council is an ad-hoc group, comprised of a diverse array of utilities, coal producers, manufacturers, constructors and state and university interests. The

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[1] Loan Guarantees For Projects That Employ Innovative Technologies, Notice of proposed rulemaking and opportunity to comment, 72 Fed. Reg. 27471 (May 16, 2007).

Council's mission is to promote and pursue research and development programs and financial incentives that lead to the cost-effective and environmentally acceptable use of coal. CURC supports clean coal technology development in the United States and worldwide and advocates for the formation of credible and effective partnerships between industry and government to pursue the development of these important technologies.

Since its formation in early 1997, CURC has focused on a variety of issues, including coal's role in supplying energy for power generation as well as the transportation and chemical industries. In a collaborative effort to define future technologies that effectively use coal, CURC and the Electric Power Research Institute (EPRI) have developed a clean coal technology roadmap that details a comprehensive strategy for coal research and development. CURC has worked with the Congress, the Department of Energy and other federal entities to ensure coal-related research and development funding and programs are sufficient and appropriately targeted to achieve the goals of the CURC technology roadmap.

2. COMMENTS ON DOE'S LOAN GUARANTEE NOPR

The "commercialization" of technologies is central to any technology development program. In order to achieve such commercialization, government assistance to support first-of-a-kind demonstrations is often necessary because the private sector is not able to shoulder the risks of such investments alone. In Title XVII of EPAct 2005, Congress established a loan guarantee program to support the commercialization of technologies that have been judged to have important public, as well as private sector value – specifically, technologies and projects that are able to avoid, reduce, or sequester pollutants or greenhouse gas emissions.

CURC has reviewed DOE's proposed regulations that establish generally applicable policies, procedures, and requirements for the Title XVII loan guarantee program. It is CURC's belief that the NOPR raises certain serious concerns regarding the implementation and success of the Title XVII loan guarantee program. The following written comments specifically address the concerns CURC has identified with respect to various provisions of the NOPR.

A. Limiting The Loan Guarantee To 90% Of 80% Of The Total Project Cost

DOE's NOPR proposes that a guarantee may cover only up to 90% of 80% of the total project cost. There is no basis in law or administrative practice for such a restriction. EPAct 2005 Section 1702 (c) authorizes that "...a guarantee by the Secretary shall not exceed an amount equal to 80 percent of the project cost..." Thus, DOE can guarantee 100% of the debt as long as it does not exceed 80% of total project cost. There is no mention in EPAct 2005 of risk sharing or any other concept that could be interpreted as support for a policy of less than 100% loan guarantee coverage for 80% of total project cost. The Federal Credit Reform Act of 1990 ("FCRA") also does not address the issue of percentage loan coverage for federal loan guarantees. Indeed, those Members of Congress most directly involved in the drafting of Title XVII have made clear to the Department their intent with respect to the level of coverage and the Department is urged to abide by that stated intent.

The projects eligible for loan guarantees under Title XVII may involve great technology risks and long development and construction times. As such, it may be difficult or prohibitively expensive for such projects to acquire adequate funding at reasonable cost. The loan guarantee program is meant to assist in the financing of such projects.

Limiting the loan guarantee to 90% of 80% of the total project cost reduces the value of the loan guarantees significantly by requiring a project to obtain non-guaranteed debt that will be very expensive. This result compromises the project's economics because lower costs cannot be passed on to project off-takers in the form of more competitive product prices. One of the principal purposes of the Title XVII loan guarantee program is to support technologies that are not yet fully commercial. Higher costs reflect that pre-commercial status. The proposed level of Title XVII loan guarantee coverage directly comprises the effort to lower costs and reduce risks.

Administrative practice in other federal loan guarantee programs allows for flexibility in setting loan guarantee limits up to statutory caps. In fact, many other federal loan guarantee programs, including the Export-Import Bank, provide 100% coverage of the loan amount. DOE should follow the examples established by these other programs and provide the maximum loan guarantee.

An appropriate concern of the government, and one that we share, is to ensure that the government is not the only party at risk in the event of partial or total project failure. Ultimately, it is the equity investors and project developers that must take this responsibility, and it is the same parties that stand to lose their investment. Therefore, DOE should guarantee 100% of the debt up to 80% of the total project cost.

B. No Pari Passu

The NOPR prohibits pari passu financing structures and prohibits any holders of non-guaranteed debt from recovering on their debt until DOE's claim is paid in full. These restrictions are a misinterpretation of the "superior rights" provision in EPAct 2005 section 1702(g)(2)(B). This EPAct 2005 section only provides that the obligation guaranteed by DOE cannot be subordinate to other financing. Thus, section 1702(g)(2)(B) clearly permits pari passu financing. Senior lenders should share equally and ratably in the right of repayment and in the security in proportion to their contribution to debt.

DOE's restriction on pari passu financing is contrary to standard lending practices. This NOPR provision will make the program less attractive to top-tier lenders because it will significantly restrict the interests of commercial lenders, effectively requiring more expensive sub-debt financing structures for projects. Thus, this provision will limit the availability of financing for projects, and could have the perverse effect of attracting and rewarding less financially sound projects that have limited access to top-tier lenders and are willing to use more expensive debt financing structures.

It is not uncommon in federal loan guarantee programs to have a second tranche of non-guaranteed commercial debt in a project. Any such commercial debt is, however, typically pari passu with the guaranteed debt. The requirement in the NOPR that any commercial debt must be

subordinate to the guaranteed debt will significantly restrict the interest of commercial lenders and the availability of financing for the program, especially in view of the size of some of the projects. Therefore, DOE should allow pari passu financing structures.

C. No Stripping

The NOPR prohibits the "stripping" of the guaranteed portion of the debt from the non-guaranteed portion of the debt. There is no statutory basis for this restriction, and it only further limits the attractiveness of the loan guarantee program for potential lenders and constrains the availability of financing for eligible projects.

Lenders, who participate in other federal loan guarantee programs, often fund their loans by transferring the loans to a special-purpose vehicle that holds only 100% federally guaranteed instruments, then sells interests in those vehicles. These vehicles are an efficient mechanism to fund these loans, and are necessary because of the very thin spreads and limited profitability of federal loan guarantee programs. The prohibition on stripping will prevent lenders from using such mechanisms, thereby reducing potential lenders' willingness to participate in the program. Therefore, DOE should not prohibit the stripping of the guaranteed portion of the debt from the non-guaranteed portion.

D. Credit Subsidy Costs And Administrative Fees Paid To DOE May Not Be Included Within Total Project Costs

Under FCRA, loan guarantees are scored on a risk-adjusted basis, based on the budget subsidy cost methodology specified in FCRA. The budget subsidy cost represents the net present value of the risk-adjusted cost to the government of the loan guarantee at the time it is issued.[2] The Title XVII loan guarantee program is unique among federal loan guarantee programs because the borrowers are expected to pay the budget subsidy cost of the loan guarantee. Regardless of whether the project defaults or not, the borrower-paid subsidy cost is retained by the government. Thus, if there is no default, the borrower-paid subsidy cost represents a financial return to the Treasury for agreeing to assume the risk during the period that the guarantee was in effect.

The NOPR specifically excludes the borrower-paid subsidy cost and administrative fees paid to DOE from the definition of project cost. These costs, in fact, are financing costs incurred and expended by the borrowers. This is especially true considering the fact that the government retains the subsidy costs and administrative fees even if there is no event of default. As such, these costs should be included in the calculation of project cost. Exclusion of these costs is inconsistent with the treatment of similar costs in commercial project financing and in other federal financial assistance programs. Thus, DOE should allow subsidy costs and administrative fees to be included in the calculation of total project costs.

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[2] For example, the net present value of the loan payoff in the event of a default, less any fees paid by the project to the government and any recoveries made by the government in the event of a default.

E. No Indication Of How Subsidy Costs Will Be Calculated

The NOPR does not give any indication of how DOE will calculate the subsidy cost. The computation of this cost should be entirely transparent so that borrowers can calculate, accurately, the costs they will have to bear when planning a project. This is especially important if, as proposed by DOE, the subsidy costs will be paid by the borrower and will not be included in the calculation of project cost. Thus, DOE should clearly identify how subsidy costs will be calculated.

F. Definition Of "General Use" Is Not Suitable

The NOPR proposes that "general use" be defined either as: 1) a technology that has been ordered for, installed, or used in five or more commercial projects in the U.S. at the time the loan guarantee is issued; or 2) a technology that has been in operation in a commercial project in the U.S. for 5 years (beginning on the date that the technology is commissioned on the particular commercial project). According to DOE's proposal, if a technology has solely been ordered for five commercial projects, regardless of whether it is in use in any project, it is considered in "general use." In the alternative, if a technology has been in use in a single project for five years, it is also considered in "general use." This proposed definition is not suitable as it relates to projects that will use technologies that have been in commercial use for other applications. Size, process configurations, and technology modifications are among the several general characteristics of projects that need to be considered when applying the "general use" definition. Therefore, DOE should consider revising its proposed definition of "general use."

G. Receipt Of Other Forms Of Governmental Assistance

DOE states in the NOPR that it is desirable that each project receive only one form of governmental assistance. While receipt of other governmental assistance does not disqualify a project from receiving a Title XVII loan guarantee, DOE will consider the extent to which a project will receive other forms of governmental assistance.

EPAct 2005, as well as other legislation, includes a number of different provisions to facilitate and encourage the construction of advanced coal-based facilities, such as the investment tax credits for advanced coal-based generating facilities. Participation in these programs should not limit a project's eligibility for Title XVII loan guarantees. These initiatives are intended to be complementary, not exclusive.

In the event that a project obtains other forms of governmental assistance and a loan guarantee under Title XVII, the cost of the loan guarantee should be adjusted to reflect the reduced risk of default on the underlying debt obligation as a result of the other support. DOE, however, should not limit a project's ability to receive more than one form of federal assistance.

3. CONCLUSION

Loan guarantees are essential to support financing in the credit markets of the types of innovative technologies envisioned in Title XVII. CURC believes new coal construction

projects will not have access to the credit markets in order to finance projects during the construction and initial operation phases without the support of a federal loan guarantee because lenders and investors in today's fixed income markets are concerned about taking major risks. The technology risks presented by the projects covered by Title XVII are likely to make lenders unwilling to extend long-term credit to such projects in a form that would be commercially viable without the backing of a federal loan guarantee. The guarantees will serve as an essential catalyst to the financing of these facilities. In doing so, the guarantees will help achieve Title XVII's goal of reducing the cost of energy from the first commercial fleet of facilities utilizing innovative technologies, ensuring rapid market penetration of the technologies.

As described above, the various restrictions and definitions proposed by DOE will severely limit a project's ability to obtain financing with commercially acceptable terms. The Department is urged to revise the proposed regulations which, in turn, will – we believe – create a viable and robust federal assistance program to encourage the development of innovative technologies designed, in part, to reduce greenhouse gases.